NOS. 22013-22018

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

LEON W. SCALES and KATHLEEN A. SCALES,
Plaintiffs-Appellees,

vs.

ROBERT A. RIDDELL,
Defendant-Appellant

ALLEN J. SUTHERLAND and ESTELLA W. SUTHERLAND,
Plaintiffs-Appellees,

vs.

ROBERT A. RIDDELL,
Defendant-Appellant

A. PAUL SUTHERLAND and MARLEINE G. SUTHERLAND
Plaintiffs-Appellees,

vs.

ROBERT A. RIDDELL,
Defendant-Appellant

MONA J. MASON (Formerly MONA J. PARKER),
Plaintiff-Appellee

vs.

ROBERT A. RIDDELL,
Defendant-Appellant.

JOSEPH LEVIKOW, JR. and ELIZABETH M. LEVIKOW,
Plaintiffs-Appellees,

vs.

ROBERT A. RIDDELL,
Defendant-Appellant

FRED J. HOWARTH and PAULINE J. HOWARTH,
Plaintiffs-Appellees,

vs.

ROBERT A. RIDDELL,
Defendant-Appellant.

BRIEF FOR APPELLEES

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

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BRIEF FOR APPELLEES

STATEMENT OF ISSUES PRESENTED

I

Whether the decision of the District Court is appealable, a

Consent (Stipulated) Judgment having been entered in the case.

II

Whether the gain derived by the taxpayers on the transfer of their interest in trusts 473 and 482 and the Kearney Park land was taxable as capital gain or ordinary income (with the exception of interest on the two Notes involved, accrued from the time they were acquited by the taxpayers until the payment was made by the Navy Department, which is conceded to be ordinary income).

STATEMENT OF THE CASE

Most of the relevant facts involved are stated in the Government's Brief. They may also be found in the Opinion of the Tax Court of the United States (Margolis v. Commissioner, 62086 T.C. Memo) and of this Court in B. B. Margolis, 337 F.2d 1001, 14 AFTR 2d 5667 (CA-9). This case involves trusts 473 and 482 in which the taxpayers participated, the trustee being Security Trust Bank, San Diego, California. These are the same two trusts which were the subject of decision by this Court in the Margolis case.

A Motion to Dismiss the appeal was filed by the taxpayers on or about August 2, 1967. This Court, in considering the Motion, apparently directed its attention to the issue of whether or not a timely Notice of Appeal had been filed by the Government. In its opinion it stated:

"Sua sponte, the Court orders the six cases listed in the caption consolidated.

"The motions to dismiss are denied. Ruby v. Secretary of United States Navy, 365 F. 2d 385, 389 (9th Cir.).

"The default in filing the records after the final judgments is not so aggravated as to require dismissal."

A Petition for Rehearing was denied.

In a Petition for Certiorari to the Supreme Court of the United States, No. 992, October Term, 1967, the taxpayers gave the following reasons for granting the Writ:

The decision of the Court of Appeals for the Ninth Circuit in the instant case is directly in conflict with five decisions of the United States Supreme Court. The decision is also in conflict with Federal decisions in eight Circuits. The Government filed a four page memorandum in opposition to the taxpayer's Petition. In that memorandum no case was cited to support the proposition that a Consent Judgment was appealable. The thrust of the Government argument was that "these cases are currently pending on the merits in the Court of Appeals. This Court ordinarily declines to review such interlocutory orders as the one below, unless there is a showing of extraordinary circumstances."

It was also asserted "the issue here is not, as the petitioners state (Pet. 2), whether a consent or stipulated judgment is appealable, but whether the District Court's judgment is a consent judgment." Attached hereto as Appendix "A" is a copy of the

stipulated judgment. The Government, in its statement of the case, notes that summary judgments were issued on February 17, 1966 and the Government on April 15, 1966 filed Notices of Appeal. A second Judgment was entered to the effect that that order was only a partial summary judgment because the factual issue of the fair market value of the retained 114 acres of land had not been determined. Then on March 16, 1967 a stipulated judgment was entered; however, no Notice of Appeal was filed as to this final judgment.

SUMMARY OF ARGUMENT

A Consent (Stipulated) Judgment was filed herein on March 16, 1967. The cases in the United States Supreme Court and all Circuits which have decided the issue, uniformly hold that a Consent Judgment is not appealable. At no stage in these proceedings has the Government cited a case contrary to this proposition. The fact of whether or not the Judgment was intended to be a Consent Judgment is of no significance because this Court held in United States v. All American Airways, 180 F. 2d 592 (CA-9) that the intention of the parties was of no consequence. It was clear in the All American Airways case that both the Government and the taxpayer thought the judgment was appealable but because of the stipulation entered into between the parties, this Court held that the judgment of the District Court could not be appealed.

On the issue of capital gains vs. ordinary income, this

Court has already passed upon that matter in Margolis v. Commissioner, supra.

The Government in its brief has attempted to introduce some new contentions having to do with "original issue discount" and "joint enterprise". Neither of these issues is related in any respect to those involved herein. The cases cited are Luckey v. Commissioner, 334 F.2d 719 (CA-9), Brady v. Commissioner, 25 T.C. 682 and Bauchard v. Commissioner, 279 F.2d 115 (CA-6). As will appear later these cases have no relation to the instant case.

The Government brief at page 10 notes:

> "On April 11, 1958, the trustee of Trusts 473 and 482 received the $1,500,000 purchase price from the Navy for the land acquired by it. Of the total sum, $261,500 was received by Trust 473 and $1,238,500 was received by Trust 482. These sums were distributed in accordance with the provisions of the agreement of December 4, 1957. (R.106)."

Thus, it is evident that payment went from the Navy directly to the Trustee of Trusts 473 and 482. In no sense could this be considered a "pay-off" of the notes or redemption thereof.

With respect to the two notes held in Trusts 473 and 482 this Court decided in the Margolis case as to the identical notes:

> "We conclude that the notes were held as investments; that to the extent that taxpayer's

share in the unpaid principal of the notes (and interest due at the time of their acquisition) exceeded his acquisition basis, the sums received upon his deposition of his beneficial interest in the trusts constituted capital gain; to the extent of his share in interest on the notes, accrued subsequent to acquisition, the sums received by taxpayer constituted an assignment of income and were taxable as ordinary income. Fisher v. Commissioner (6 Cir. 1954) 209 F.2d 513 (45 AFTR 150), cert. denied (1954) 347 U.S. 1914."

This issue is therefore already settled. Furthermore, the decision of the lower Court in the present case is consistent with the above decision in that accrued interest was held to be ordinary income.

ARGUMENT

I

A STIPULATED JUDGMENT IS NOT REVERSIBLE.

Regarding the Consent (Stipulated) Judgment filed herein, the plaintiffs' Memorandum of Points and Authorities attached to the Motion to Dismiss stated: "As a matter of principle it would seem obvious by its very nature, that a Consent or Stipulated Judgment would not be appealable; . . . ." Because it seemed unnecessary to elaborate on this established proposition, only three cases

were cited. Taxpayers did not cite the case of United States v. All American Airways, 180 F. 2d 592 from this Circuit nor some of the cases from eight other Circuits and the United States Supreme Court which uniformly hold that a Consent Judgment is not reversible. The Government has not cited one case from the Circuit Courts of Appeals or the Supreme Court contrary to this proposition. It may be gathered from the short statement made by this Court in denying the Motion to Dismiss in the cases at bar, that the Court made its decision on the basis of the Notice of Appeal issue. The Court cited Ruby v. Secretary of United States Navy, 365 F. 2d 385, which did not involve the matter of a Consent Judgment.

This Court squarely met the Consent Judgment issue in United States v. All American Airways, 180 F. 2d 592. In the per curiam opinion it is stated: "This appeal is from a Consent Judgment -- a Judgment which was consented to by Appellant and Appellee and which the District Court had jurisdiction to render. Such a Judgment is not reversible." (Citations). The Record on Appeal, No. 12347, United States v. All American Airways, Inc., reveals the fact that neither in the Brief for the United States nor for Appellee, All American Airways, Inc., was any reference made to a Consent Judgment. Obviously, both parties thought the judgment was appealable. After this Court held on its own Motion that the Judgment in the above case was not reversible, a Petition for Rehearing was filed by the United States. In its Brief the Government stated: "The appellee has at no time claimed that the

Judgment appealed from was a 'Consent Judgment' -- neither in its Brief nor at the oral argument before the Court." In a six page affidavit attached to the Petition for Rehearing, Eugene Harpole, Esquire, representing the Government explained that the Stipulation filed was not intended to result in a Consent Judgment and that "Affiant had no authority or instructions in this case to consent to the entry of a judgment in plaintiffs' favor and against the United States. Affiant at no time had any intention of consenting to a Judgment in plaintiffs' favor and against the United States." Attached to Mr. Harpole's affidavit are Exhibit A and Exhibit B which clearly indicate that both parties understood that an appeal would be taken. (See Exhibit A and Exhibit B and excerpts from the Record on Appeal in that case in Appendix "B" herein). In the All American Airways case, as is shown on pages 13, 14, 15 and 16 of the Record (No. 12347), the Government attorney and the attorney for plaintiff signed a Stipulation. The Judgment itself was signed only by the United States District Judge and was not designated a Stipulated or Consent Judgment.

As shown in the copy of the stipulated judgment in this case, attached hereto as Appendix "A", the Judgment itself was designated a "Stipulated Judgment" and recited in paragraph Two: "2. There exists no further issues left to be litigated, and, therefore, this Stipulated Judgment coupled with the Judgment entered on February 17, 1966 constitutes a final judgment of this matter."

It is thus crystal clear that the instant case comes squarely

within the decision of United States v. All American Airways and the decisions listed below.

The five decisions of the United States Supreme Court which hold a Consent Judgment not to be reversible are:

Pacific R. Co. v. Ketchum, 101 U. S. 289, 295, 25 L. Ed. 932, 935 (1880);

United States v. Babbitt, 104 U. S. 767, 768, 26 L. Ed. 921, 922 (1882).

Nashville, C. & St. L. Ry. Co. v. United States, 113 U. S. 261, 266, 28 L. Ed. 971, 973, 5 S. Ct. 460 (1885);

Swift & Co. v. United States, 276 U. S. 311, 324, 72 L. Ed. 587, 596, 48 S. Ct. 311 (1928);

N. L. R. B. v. Ochoa Fertilizer Corp., 368 U. S. 318, 323, 7 L. Ed. 2d 312, 313, 82 S. Ct. 344 (1961).

In addition to the All American Airways case decided in this Circuit the following eight Circuits held consent decisions not reversible.

C. A. 1 - Ballot v. United States, 171 Fed. 404, 405 (1909);

C. A. 2 - Kelly's Trust v. Commissioner, 168 F. 2d 198, 199 (1948);

C. A. 5 - White & Yarborough v. Dailey, 228 F. 2d 836, 837 (1955);

C. A. 6 - Pergola v. Penn R. Co., 311 F. 2d 887,

839 (1963);

C. A. 7 - Stewart v. Lincoln-Douglas Hotel Corp., 208 F. 2d 379, 381 (1953);

C. A. 8 - Walling v. Miller, 138 F. 2d 629, 631 (1943);

C. A. 10 - United States v. Star Construction Co., 186 F. 2d 666, 669 (1953);

Dist. of Col. - Curry v. Curry, 65 App. D. C. 47, 79 F. 2d 172, 174 (1935).

A brief statement, directly in point, from the above decisions of the Supreme Court and the Circuit Courts is more enlightening than a summary of those decisions:

> Pacific R. Co. v. Ketchum, supra -- "If, when the case gets here, it appears that the decree appealed from was assented to by the appellant, we cannot consider any errors that may be assigned which were in law waived by the consent, . . ." 101 U. S. at 295;
>
> United States v. Babbitt, supra -- "In R. R. Co. v. Ketchum, 101 U. S., 289, we decided that when a decree was rendered by consent, no errors would be considered here on appeal which were in law waived by such a consent. . . . The consent to the judgment below was in law, a waiver of the error now complained of." 104 U. S. at 768;
>
> Nashville, C. & St. L. Ry. Co. v. United States,

the appeal fails." 228 F. 2d at 837 (C. A. 5);

Pergola v. Penn R. Co., supra -- "No error can be asserted in the dismissal of the claim under the Federal Employers' Liability Act as this was done with the consent of plaintiff." 311 F. 2d at 839 (C. A. 6);

Stewart v. Lincoln-Douglas Hotel Corp., supra -- "It is a generally accepted rule of long standing that a party who agrees or consents to the entry of an order or judgment thereby waives his right to claim that the trial court committed error in the entry of the order." 208 F. 2d at 381 (C. A. 7);

Walling v. Miller, supra -- "All errors going to the merits . . . are waived by consent to the decree." 138 F. 2d at 631 (C. A. 8);

United States v. All American Airways, supra -- "Such a [consent] judgment is not reversible." 180 F. 2d at 592 (C. A. 9);

United States v. Star Construction Co., supra -- "A party is not aggrieved by a ruling regularly made, with his express or implied consent," 186 F. 2d at 669 (C. A. 10);

Curry v. Curry, supra -- "For a consent decree, . . . is valid and binding upon all parties consenting, open neither to direct appeal nor col-

lateral attack." 79 F. 2d at 174 (C. A. Dist. of Col.).

Counsel for taxpayers, in his research of cases involving consent or stipulated judgments (including the two circuits (3d and 4th) not listed above) has been unable to find any authority holding directly or indirectly that a consent judgment is appealable.

Additionally, it does not appear possible that any exceptions to the rule mentioned in N. L. R. B. v. Ochoa Fertilizer Corp., supra, apply. The exceptions mentioned are lack of Federal jurisdiction, lack of actual consent, and fraud in the procurement. The Federal Courts obviously have jurisdiction of tax matters and the fact that the consent judgment (Appendix A) was prepared in the office of the United States Attorney and contains the statement, "There exists [sic] no further issues left to be litigated and, therefore, this Stipulated Judgment . . . constitutes a final judgment of this matter," precludes a claim of fraud or lack of consent.

It is thus apparent that if this Court decides the lower court's judgment to be reversible, it will be in direct conflict with the five United States Supreme Court cases cited above together with cases from eight Circuits. As previously stated, the Government has not cited one appellate case holding a Consent or Stipulated Judgment to be appealable.

II

THE GAIN ON THE NOTES WAS NOT DISCOUNT INCOME

The Government argues "that the gain from the payment or retirement of the Notes does not qualify for capital gains treatment, since the gain represents discount income, the equivalent of interest and is taxable as ordinary income. United States v. Midland-Ross Corp., 381 U S. 54." (Government's brief p. 21) Original issue discount has been defined as the difference between the issue price of the obligation and its stated redemption price at maturity. The two notes involved herein were acquired by the taxpayers from a third party, Harry M. Redfield, Trustee for an Iowa estate (TC opinion B. B. Margolis p. 62-513; also Record on Appeal Court of Appeals 9th Circuit No. 18499 and 18500, Volume I, p. 129). It would indeed be a startling surprise to the financial world if, under the circumstances in this case, it was held that the difference between the purchase price and the face amount of the notes were deemed to represent original discount income.

In United States v. Midland-Ross Corp., supra, the Supreme Court stated "Earned original issue discount serves the same function as stated interest, conceded ordinary income and not a capital asset; it is simply 'compensation for the use or the forbearance of money.' " It is further stated "the $6 earned on a one-year note for $106 issued for $100 is precisely

like the $6 earned on a one-year loan of $100 at 6% stated interest. The application of general principles would indicate, therefore, that earned original issue discount, like stated interest, should be taxed under §22(a) as ordinary income."

Obviously, there was no "original discount" in this case. The transfer was from Harry M. Redfield, a third party, not the issuer of the notes. The record is void of any suggestion of notes issued at discount.

To repeat, the two notes were not issued to the taxpayers. They acquired the notes from a third party so there can be no issue here of discount income.

III

THE GAIN REALIZED BY THE TAXPAYERS ON THE SALE OF THE KEARNEY PARK LAND AND THE DISTRIBUTION OF ONE-HALF OF THAT PORTION OF SUCH LAND AS WAS NOT SOLD, WAS TAXABLE AS CAPITAL GAIN.

The Government has advanced the argument that "where two or more individuals combine in a joint enterprise for their mutual benefit with an understanding that they are to share in the profits or losses, each to have a voice in the management, and the venture acquires property and holds it for sales to customers in the ordinary course of the business of such venture, the profits are clearly taxable as ordinary income rather than as capital gains. Luckey v Commissioner, 334 F. 2d 719 (CA-9); Brady v. Commissioner, 25 TC 682, see also Baushard v. Commissioner, 279 F. 2d 115 (CA-6)." (Govt. Br. p. 25).

In the Brady case there were sixty-eight improved residential lots which were sold in the following way as indicated on pages 685 and 687 in the Tax Court Opinion.

> Fifteen lots were sold on August 21, 1946, one lot October 18, 1946, ten lots January 31, 1947, one lot May 5, 1947, two lots September 25, 1947, seventeen lots October 8, 1947, eighteen lots October 9, 1947 and four lots August 2, 1948.

Since the issue involves "sales to customers in the ordinary course of business" this is a far cry from the involuntary conversion feature of the instant case where one transfer was made. It should be noted also that a Mr. Lawler who was associated with the

petitioner Brady "engaged principally in the management of real estate" and Mr. Slocum, another associate, "was a licensed real estate dealer who had carried on that business for nearly forty years." A Mr. Christo, the only other associate, "was a member of the Pittsburgh Real Estate Board who advertised and otherwise held himself out as being in the real estate business and he derived a substantial portion of his income from real estate sales."

In Luckey v. Commissioner, supra, the taxpayers were part of a syndicate of seven members organized to purchase and develop some lakeshore land. The taxpayers received a part of the distributive share in the form of lots rather than profits. The petitioner received seven lakefront lots and sold four of them during the taxable years 1958 and 1959. It was held that the taxpayer received the lots in a distribution from a joint venture in which he participated. But note that the special provision of § 735(a)(2) of the 1954 Code applied and that made his profit, on the resale of the lots (within five years after receiving them) taxable as ordinary income. The gist of the holding was that the associated corporation developed tracts, built houses on the tracts and sold them as part of the taxpayers' business. These facts have no relation to the instant case.

In the Baushard case, supra, the petitioner joined with "a close friend named Tonti", who was a real estate developer, in the development of certain property. A local druggist by the name of Haney invested money in the venture. The property was purchased for approximately $77,000 and title was taken in the name of two trustees. A corporation was organized by Tonti for the purpose of subdividing and improving the property.

Sixty-five separate sales were made of the lots involving 23 purchasers. The total sales prices received by the corporation was $574,208. The Court held that the lots from which the taxpayer realized gains were held primarily for sale to customers and accordingly were not capital assets within the meaning of the statute. In its opinion the Sixth Circuit stated: "Whether the arrangements between the two were technically sufficient to constitute a joint venture we regard as immaterial. If not a joint venture, the relationship of principal and agent clearly existed." It is thus crystal clear that the Luckey, Brady and Baushard cases have no relevance in this case whether or not there was a joint venture. Here there was no subdivision and sale of lots. In fact, there was only one transfer and that was to the Navy Department under threat of condemnation.

This Court is dealing with the same two trusts (Nos. 473 and 482) which were the subject of decision in Margolis v. Commissioner, supra. It was there stated: [6] "By the agreement of June 15, 1956, the trusts acquired a new interest in the property - a right to share in any gain upon their sale. This right, secured by a Trust Deed to the property, constituted an interest in the equity of the property itself which interest in property was held for sale by the trusts."

It should be noted that this Court did not say that the trusts held the property for sale to customers in the ordinary course of business. The Code provision clearly specifies that the property must be held for sale in the ordinary course of

business if ordinary income rates are to apply. In the Margolis case as the opinion of this Court shows, Margolis' transactions were considered "in seven groupings." Margolis, as the opinion indicates, "for a long period of years" had been "engaged in over 4,000 real estate transactions." This Court held in the Margolis case that he was in the business of buying and selling real estate and that his interests in Trusts 473 and 482 constituted capital assets.

The Government has failed to recognize the basis of this Court's decision. The Margolis interests were capital assets but Margolis was in the business of buying and selling real estate. Therefore in his particular case the gain should be treated as ordinary income simply and solely because he was in the business of buying and selling real estate in the ordinary course of his business.

Since our taxpayers were not in the business of buying and selling real estate to customers in the ordinary course of business they are entitled to treat the proceeds under the capital gains provisions. This follows irrevocably from the above quoted opinion of this Court in Margolis, where it is said:

> "By the agreement of June 15, 1956, the trusts acquired a new interest in the property - a right to share in any gain upon their sale. This right, secured by a trust deed to the property, constituted an interest in the equity of the property itself, which interest in property was held for sale

by the trusts."

In the next paragraph this Court then gives the basis for holding that Margolis could not have the benefit of capital gains treatment. The trust was to be ignored and the sale treated "as a sale of property held for sale in the ordinary course of business." This is not surprising since the record shows Margolis had been "engaged in over 4,000 real estate transactions."

IV

THERE WAS NO "PROPERTY HELD BY THE TAXPAYER PRIMARILY FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF HIS TRADE OR BUSINESS". 1/

There is no quarrel with the statement in the Government brief, page 23, that: "The question of whether the property involved was so held within the meaning of the exclusionary language of § 1221(1) is essentially a question of fact to be determined from the circumstances of each case." Five cases are cited to support this proposition including Starke v. Commissioner, 312 F. 2d 608, and Austin v. Commissioner, 263 F. 2d 460, decided in this Circuit. In the Starke case the taxpayer made many sales of lots in the San Diego area. He reported the income as capital gains and the Commissioner determined

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1/ This phrase is part of § 1221 reproduced in the appendix to the Government Brief.

that it should have been reported as ordinary income. The Tax Court sustained the Commissioner. This Court reversed the Tax Court and agreed with the taxpayer stating "No one element is dispositive. But here there is no evidence of a campaign to sell, no advertising, no 'holding out' ".

In Austin v. Commissioner, supra, the taxpayer acquired and sold many lots in the Manhattan Beach area of California during the period 1918 to 1952. This Court reversed the Tax Court which held that the income was ordinary income and not capital gains. The Court stated "It is our view, based upon the entire record, that Petitioner was not engaged in the business of selling real property during the tax years in question, and that the properties sold were not being held primarily for sale to customers." In the course of its opinion this Court stated:

> "We come now to the question as to whether or not these properties were held by petitioners primarily for sale to customers in the ordinary course of petitioner's trade or business. Admittedly, petitioner was engaged in the practice of law throughout the period involved. He was also active in the civic affairs of his home city. Was petitioner also engaged in the business of selling real estate, and was the property held primarily for sale to customers? The words and phrases 'trade or business', 'ordinary' and 'customers' are to be construed in their ordinary meanings. 'To be engaged in the

real estate business means to be engaged in that business "in the sense that the term usually implies." ' Yunker v. Commissioner of Internal Revenue, 256 F.2d 130 [1 AFTR 2d 1559]. The word 'business' ' . . . implies that one is kept more or less busy, that the activity is an occupation. It need not be one's sole occupation, nor take all his time. It may be only seasonal, and not active the year round. It ordinarily is implied that one's own attention and efforts are involved . . . .' Snell v. Commissioner of Internal Revenue, 97 F.2d 891 [21 AFTR 608]. As stated in Fahs v. Crawford, 161 F.2d 315 [35 AFTR 1228], at page 317, 'Of course, a person may be engaged in more than one business, and may carry on his business through others. Carrying on a business, however, implies an occupational undertaking to which one habitually devotes time, attention, or effort with substantial regularity. Merely disposing of investment assets at intermittent intervals, without more, is not engaging in business, even though some preliminary effort is necessary to render the asset saleable.

"The record in this case discloses that neither petitioner was a licensed real estate agent or broker. They did no advertising whatsoever to

promote the sales of their property. They did not post any 'for sale' signs on their property. They did not list their property with real estate brokers. The record does not show a single activity on the part of the petitioners that they were holding their property for sale. All that the record shows is that the property was being held by petitioners." (Emphasis added).

In the case at bar there is not an iota of evidence in the record indicating that the taxpayers advertised the property, posted "For Sale" signs on the property or listed the property with real estate brokers. As in the Austin case "all that the record shows is that the property was being held by (taxpayers)".

Last month Commissioner v. Tri-S Corporation (No. 9839) was decided in the Tenth Circuit. That case is startlingly similar to the instant case. Eighty acres of "raw and wholly unimproved land" were bought by the taxpayer on October 10, 1960. The State of Colorado acquired 20 acres of this land under threat of condemnation on October 6, 1961. The taxpayer on his return reported the gain on the 20 acres as capital gain. The Commissioner held it to be ordinary income but on petition to review the Tax Court decided it was capital gain. (Tri-S Corporation v. Commissioner, 48 T.C. 316.) The Court of Appeals affirmed.

In its Opinion the Tenth Circuit noted:

"During all times here material, the taxpayer was engaged in the business of a residential land

developer, and developed and sold improved lots and homes to individual buyers. 'It sometimes' purchased 'finished sites,' built 'houses on such sites' and sold 'them to prospective home owners.'

"When it purchased the 80-tract of raw land, the taxpayer intended and planned at some time in the future to develop 60 acres of the 80-acre tract by constructing streets, sidewalks, gutters, sewers, and water lines, and to build homes on lots and sell them to prospective customers. It also then intended and planned at some time in the future to develop the 20-acre tract sold to the State as a shopping center site and to improve such 20-acre tract for that purpose. Such future plans were evidenced by a master plat of the 80-acre tract, showing planned future development, prepared by the taxpayer before April 7, 1961."

Further on the Court stated:

"In 1961 the State of Colorado desired to acquire the 20-acre tract, later conveyed to it, for the construction of an arterial highway, extending southerly from Interstate Highway No. 70. On April 7, 1961, the Colorado State Highway Department notified the taxpayer that condemnation proceedings would be instituted to take a portion of the land (the 20-acre tract) by eminent domain for use as an arterial highway extending southerly from Interstate Highway No. 70.

"Negotiations between the taxpayer and the

Highway Department followed and on July 25, 1961, the taxpayer agreed to convey such 20-acre tract to the State of Colorado for $130,000. The conveyance was consummated on October 6, 1961.

"The Tax Court found the facts as above stated, and further found:

"The taxpayer, 'after April 7, 1961,' was not holding the 20-acre tract ' "primarily for sale to customers in the ordinary course of his trade or business" within the meaning of section 1221(1)' [4] and did not sell such 20-acre tract 'to a customer in the ordinary course of its business It did not seek the sale to' the State of Colorado 'or any other sale of that raw land.' 'The property sold was a capital asset at the time of the sale.'

"In Coffey v. United States, 10 Cir., 333 F.2d 945, 947, the court quoted with approval from Friend v. Commissioner, 10 Cir., 198 F.2d 285, 287, as follows:

> 'It is the well settled rule that whether property sold or otherwise disposed of by a taxpayer was held by him for sale to customers in the ordinary course of his trade or business, within the meaning of section 117 [§ 1221], is essentially a question of fact. * * *'

"The taxpayer never at any time held such

20-acre tract for sale in its raw state to customers in the ordinary course of its trade or business. It intended to sell such 20-acre tract at some time in the future, only after it had improved the same so as to make it suitable for a shopping center or homesites.

"During the period from April 7, 1961, to October 6, 1961, it is clear under the facts that the taxpayer was not holding the 20-acre tract primarily for sale to customers in the ordinary course of its trade or business. While prior to April 7, 1961, it had intended at some time in the future to improve the 20-acre tract, so as to render it suitable for a shopping center and to make disposition of it for that purpose, from and after that date it would have been futile for it to have undertaken to carry out such future plans. It clearly did not hold such land for sale to customers in the ordinary course of its trade or business on July 25, 1961, when it agreed to convey the 20-acre tract to the State of Colorado, and on October 6, 1961, when it consummated such conveyance.

"Accordingly, the decision of the Tax Court is affirmed.

"4 26 USCA § 1221 (1954 Ed.) in part here material reads:

" '§ 1221. Capital asset defined

> 'For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include-
>
> '(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. . . .' "

This rather lengthy quotation is inserted to demonstrate what is contended to be the proper application of the capital gains provisions, particularly in a condemnation situation. In Tri-S Corporation the taxpayer "was engaged in the business of a residential land developer" and purchased the 80 acres with intention of having the condemned 20 acres developed "as a shopping center site". Nevertheless, the gain was held to be capital gain not ordinary income.

It is evident that the property involved in Trusts 473 and 482, herein, was handled in such a way that even the inferences possible in Tri-S Corporation could not here convert the proceeds into ordinary income.

The exception that applies to capital assets cuts both ways as indicated in James M. Fidler v. Commissioner, 20 T.C. 1081, 231 F.2d 138 (CA-9). The taxpayer was a radio announcer who had bought certain books and manuscripts which he sold at a loss of $4,750. He deducted the loss on his tax return as an ordinary loss. The Tax Court in deciding that it was a loss from a sale of capital assets commented "had petitioner sold the literary properties at a profit, he would no doubt have claimed that they

were capital assets and that he would have been entitled to the favorable treatment accorded to capital gains."

This Court on appeal (Fidler v. Commissioner, 231 F. 2d 138) sustained the Tax Court stating that Fidler did not hold the property "primarily for sale to customers in the ordinary course of his trade or business. . . . He was not 'engaged in a trade or business with respect to the literary properties.' "

By the same token, if the six taxpayers herein had been unfortunate enough to take a loss on the venture, the Government would undoubtedly have taken the position that it was a capital loss and not an ordinary loss.

V

THE NOTES ARE CAPITAL ASSETS

It is difficult to understand how the Government can argue that the amount of the difference between the cost of the notes and their face value credited when the $1,500,000 was received from the Navy constituted ordinary income. This Court in the Margolis case settled this issue once and for all. In "(5)(a) as to the notes" it says: "The Tax Court has refused to treat the notes as investments." Then after quoting from the Tax Court opinion it states: "We cannot agree . . . ." "We conclude that the notes were held as investments; . . . ."

CONCLUSION

For the foregoing reasons it is submitted that the judgment of the lower Court should be affirmed.

Respectfully submitted,

ERNEST R. MORTENSON

Attorney for Appellees.

APPENDIX A

JOHN K. VAN de KAMP
United States Attorney
LOYAL E. KEIR
Assistant U. S. Attorney
Chief, Tax Division
DONALD M. FENMORE
Assistant U. S. Attorney
808 U. S. Courthouse
Los Angeles, California
Telephone: 688-2434

Attorneys for Defendant

UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

LEON W. SCALES and KATHLEEN A. SCALES, et al.,

Plaintiffs,

ROBERT A. RIDDELL.,

Defendant.

In Case No. 65-269-PH and the following numbered cases:

65-319-PH; 65-320-PH:65-469-PH;

65-526-PH; 65-932-PH

STIPULATED JUDGMENT

IT IS HEREBY STIPULATED AND ADJUDGED by and between Allen J. Sutherland and Estella W. Sutherland, plaintiffs herein, and the United States of America, defendant herein,

through their respective counsel of record, that:

1. The fair market value of the subject 114 acres of real property is $250,000.00.

2. There exists no further issues left to be litigated, and, therefore, this Stipulated Judgment coupled with the Judgment entered on February 17, 1966 constitutes a final judgment of this matter.

DATED: March 8, 1967

JKV
LEK
DMF
Jy

/s/ Ernest R. Mortenson
ERNEST R. MORTENSON
Attorney for Plaintiffs

JOHN K. VAN de KAMP
United States Attorney
LOYAL E. KEIR
Assistant U. S. Attorney
Chief, Tax Division
DONALD M. FENMORE
Assistant U.S. Attorney

/s/ Donald M. Fenmore
DONALD M. FENMORE
Attorneys for United States of America

IT IS SO ORDERED this
16 day of March, 1967
/s/ Peirson M. Hall

United States District Judge

I hereby attest and certify on Jun 1 1967 that the foregoing document is a full, true and correct copy of the original on file in my office, and in my legal custody.

JOHN A. CHILDRESS
CLERK, U.S. DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

By /s/ Danny Ussery Deputy

DANNY USSERY

APPENDIX B

United States v. All American Airways, Inc., 180 F. 2d 592 (C. A. 9) No. 12347

[Title of District Court and Cause.]

STIPULATION

It Is Stipulated between plaintiff and defendant United States of America through their attorneys of record:

1. That defendant United States of America will not file an answer or other or further pleading to plaintiff's complaint.

2. That the action may be dismissed as to all fictitiously named defendants.

3. That plaintiff may apply forthwith for judgment in the form attached hereto marked Exhibit A and that the judgment may be signed and entered by the court exparte and without service of a three-day written notice as provided by Rule 55(b)(2), Federal Rules of Civil Procedure.

4. That the judgment may be signed and entered on the allegations in plaintiff's complaint without supporting evidence [13] and without other or further compliance with rule 55(e), Federal Rules of Civil Procedure.

Dated: June 3rd, 1949.

JAMES M. CARTER,
United States Attorney.
E. H. MITCHELL,
Assistant U. S. Attorney.
EUGENE HARPOLE and
ROBERT D. SCOTT,
Special Attorneys, Bureau of Internal Revenue.

By /s/ EUGENE HARPOLE,
Attorneys for Defendant,
United States of America.
GUTHRIE, DARLING &
SHATTUCK,
By /s/ MILO V. OLSON
Attorneys for Plaintiff.

[Endorsed]: Filed June 7, 1949.

[Title of District Court and Cause.]

JUDGMENT

The motion of defendant United States of America to dismiss the above-entitled action having been argued, heard and denied on May 16, 1949, and plaintiff and defendant United States of America having stipulated in the record of the above-entitled proceeding that no answer or further pleading to plaintiff's complaint will be filed by defendant United States of America, and the court having been fully advised and good cause therefor appearing,

It is Found, Ordered, Adjudged and Decreed:

1. That this Court has jurisdiction of the cause of action set forth in plaintiff's complaint.

2. That all of the allegations in plaintiff's complaint are true, except the allegations in Paragraph III thereof which are found to be immaterial.

3. That plaintiff is the owner of the following described [18] airplanes which are the subject matter of the within action:

One Douglas DC-3, No. NC54312, purchased May 19, 1948;

One Douglas DC-3, No. NC49277, purchased May 19, 1948;

One Douglas DC-3, No. NC16839, purchased June 15, 1948.

4. That the action be and it is dismissed as against the fictitiously named defendants.

5. That plaintiff is a bona fide purchaser of the airplanes described in Paragraph 3 of this judgment without notice of any claim of defendant, United States of America, in and to any of said airplanes because of the failure of defendant, United States of America, to record any notice or claim of its tax lien or liens against Northern Airlines, Inc., with the Civil Aeronautics Board or the administrator of the Civil Aeronautics Board in accordance with the provisions of the Civil Aeronautics Act prior to the time plaintiff acquired ownership of said airplanes.

6. That defendant United States of America has no estate, right, title, interest or lien in or to any of the airplanes described in Paragraph 3 of this judgment, prior, superior or adverse to the estate, right, title and interest of plaintiff.

7. That defendant United States of America and all persons, firms, corporations and bodies politic acting under or through defendant United States of America be and they are forever barred and enjoined from asserting any claim in or to any of the airplanes described in Paragraph 3 of this judgment as against plaintiff's interest and ownership therein, by reason of or arising out of any unpaid taxes owing or claimed to be owed by Northern Airlines, Inc., to defendant United States of America.

8. That plaintiff's right, title, interest and possession in and to the airplanes described in Paragraph 3 of this judgment be and they are quieted against any right, title, interest, lien or

claim of defendant United States of America or any person, firm, corporation or body politic acting under or through defendant United States of America.

Dated: June 7, 1949.

By /s/ JACOB WEINBERGER,
U. S. District Judge.

[Endorsed]: Filed June 7, 1949 [19]

3. The mechanics which the parties chose in the court below, for the purpose of giving effect to their intention to eliminate further useless proceedings in the trial court and to pave the way for the prompt entry of a judgment from which United States could prosecute its appeal, consisted of the stipulation. [R. 13-14.] Aside from disposing of the action as to the fictitiously named defendants, the stipulation does no more than state: (1) that the United States would not plead over, i. e., that it would stand on its motion to dismiss; (2) that the appellee could apply forthwith for judgment, which was approved as to form; (3) that the three-day notice required by Rule 55(b)(2) of the Federal Rules of Civil Procedure was waived; and (4) that the judgment could be entered on the allegations of the complaint, without the introduction of evidence prescribed by Rule 55(e) of the Federal Rules of Civil Procedure.

We submit that a detailed analysis of the terms of the stipulation establishes beyond the possibility of any doubt that, other than as to form and as to the procedural requirements above indicated, there was no consent by the United States to a judgment against it. The first paragraph merely announces that the United States would not plead over, while the second paragraph disposes of the fictitiously named defendants, and, quite obviously, no

consent to a judgment could possibly be "interpreted" from either of those paragraphs. The statement in paragraph three that "plaintiff may apply forthwith for judgment in the form attached hereto marked Exhibit A" [R. 13] is clearly no more than an approval as to the form of the judgment,[5/] and obviously no consent can be implied from that. The further statement in paragraph three of the stipulation, "that the judgment may be signed and entered by the court ex parte and without service of a three-day written notice as provided by Rule 55(b)(2), Federal Rules of Civil Procedure" [R. 13], is clearly only a waiver of that three-day notice,[6/] and it would be palpably wrong to construe that language as amounting to a consent on the part of the United States to the entry of a judgment against it, we submit. . . . Besides serving as a deterrent against such cooperation between counsel in the future, the decision of this Court in this case, if permitted to stand, would constitute an unjust and unwarranted deprivation of the right of the United States to appeal by erroneously assuming that the United States had consented to the judgment against it, whereas in fact it had merely agreed to the form of the judgment and agreed to do away with certain procedural requirements.

4. It is our position that the language of the stipulation itself establishes beyond any possible doubt that, aside from agreeing as to matters of form or procedure, the United States did not consent to the entry of a judgment against it. However,

stipulation -- which we emphatically insist is impossible -- such doubt would be readily dispelled by an analysis of the judgment itself. [R. 14-16] It does not contain even the slightest suggestion that the judgment is a "consent judgment." The preliminary or opening paragraph of the judgment [R. 14-15] merely shows that the court is deciding the case after the United States, whose motion to dismiss had been denied, had declined to plead over -- i. e., was standing on its motion, just as a litigant would stand on his demurrer under the old practice.

7. Finally, attention is invited to a further, and indeed quite significant, indication that the judgment appealed from was not a "consent" judgment. The appellee has at no time claimed that the judgment appealed from was a "consent judgment" -- neither in its brief, nor at the oral argument before the Court. 8/

8/ No question as to whether the judgment appealed from might be a "consent judgment" was raised even by the Court at the oral argument. Aside from the merits of the appeal, the only query raised by the Court was as to whether Rule 55(e), requiring the submission of evidence before a default judgment can be entered against the United States, might not have to be complied with literally -- as to which query counsel pointed out that, in substance, what had been done was the same as stipulating the facts in the case.

Wherefore, in view of the foregoing, the United States respectfully requests that this, its petition for rehearing, be granted by this Honorable Court, and that the Court's per curiam opinion and judgment rendered and entered herein on February 17, 1950, be vacated and set aside and that a rehearing be granted and the appeal of the United States be considered on the merits.

Respectfully submitted,

Theron Lamar Caudle,
Assistant Attorney General;

Ellis N. Slack,

Harry Marselli,
Special Assistants to the Attorney General.

Ernest A. Tolin,
United States Attorney;

E. H. Mitchell,
Assistant United States Attorney.

March 13, 1950.

(Attached to Harpole Affidavit)

Exhibit A.

Stanley W. Guthrie
Hugh W. Darling
Edward S. Shattuck
Milo V. Olson
Arthur C. Jones, Jr.
George G. Gute

Trinity 8104

Law Offices
GUTHRIE, DARLING & SHATTUCK
737 Pacific Mutual Building
Los Angeles 14

May 16, 1949

Mr. Eugene Harpole
Mr. Robert D. Scott
Bureau of Internal Revenue
1727 Federal Building
Los Angeles 12, California

Gentlemen:

All American v. U. S.

Enclosed is a notice of ruling. I understand the defendant will not answer but will take an appeal.

Cordially,

MILO V. OLSON
MILO V. OLSON,
of
GUTHRIE, DARLING & SHATTUCK.

MVO:r

Exhitib B.

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WASHINGTON DC 5-31-49 1114A

CARTER UNITED STATES ATTORNEY
LA

RE ALL AMERICAN AIRWAYS INC VERSUS UNITED STATES NUMBER 8860-WC YOUR REFERENCE EHM/EH/ RDS/MRK LET JUDGMENT BE ENTERED ON GOVERNMENTS MOTION TO DISMISS. ADVICE CONCERNING ATTORNEY GENERALS DICISION ON QUESTION OF APPEAL WILL BE FORWARDED ON AN EARLY DATE.

CAUDLE ASSISTANT ATTORNEY GENERAL JUSTICE DEPARTMENT

8860-WC

RR 1116A